

Globalisation winds in the Latin American banking industry



An Economist Intelligence Unit report sponsored by
MasterCard Worldwide Latin America & Caribbean



Preface

Globalisation winds in the Latin American banking industry is an Economist Intelligence Unit briefing paper, sponsored by MasterCard. The Economist Intelligence Unit's editorial team conducted the interviews, executed the survey and wrote the report. The findings and views expressed in this report do not necessarily reflect the views of the sponsor. Kim Andreasson was the editor and project manager. Thierry Ogier was the author of the report. Maureen Van Kuren was responsible for layout and design.

Our research drew on two main initiatives. We conducted a global online survey in October 2007 of 208 financial services executives in order to assess the impact of globalisation on the Latin American banking industry. To supplement the results, we also conducted in-depth interviews with financial services experts in Latin America. Our thanks go out to all survey respondents and interviewees for their time and insights.

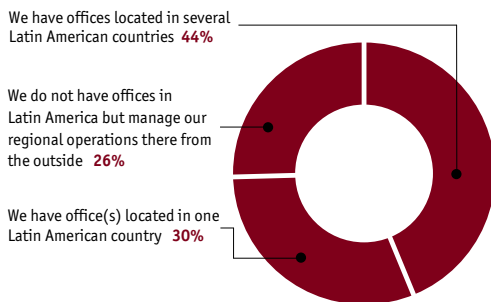
June 2008



Summary

Globalisation forces have a strong impact on the Latin American financial services industry, and consolidation is far from over, especially in retail banking. Most financial services executives surveyed for this report feel that the trend will accelerate in the medium term and that local banks are likely to become the target of foreign acquirers. A key finding of the survey is that a majority of executives, especially those who are based in North America, expect Latin America's importance to grow as a proportion of their organisation's business.

Which of the following best reflects the way your organisation manages its operations in Latin America?



Most survey respondents expect the global economy to have a greater impact on their company's operations than local markets will have in the medium term. As a result, the current financial turmoil worldwide is likely to affect the region, although Latin America looks less vulnerable than it used to.

Brazil is considered the main investment destination in the future, with Mexico and Argentina

distant runners-up. Retail banking, meanwhile, is the business area where competition is expected to increase the most within the next five years.

Executives expect Latin America's importance to grow as a proportion of their organisation's business

Key findings

- *Latin America is increasingly important to organisations' globalisation strategies.* A large majority of executives surveyed expect that a greater share of banking revenue will come from Latin America in the medium term. This trend is especially strong among executives based in North America.
- *Competition to attract customers in Latin America will intensify.* Meanwhile, financial services in the region are still relatively underdeveloped and organisations are in a position to enhance their portfolio of financial products.
- *Brazil is the most attractive market in the region.* Brazil is clearly identified as the favourite investment destination by survey respondents (71%), followed by Mexico (43%) and Argentina (38%).
- *Competition in retail banking will increase the most.* According to survey respondents, more than one-quarter (27%) expect the greatest increase in competition in retail banking, compared with 17% in investment banking, 15% in corporate banking and 12% in consumer finance and cards.



Introduction

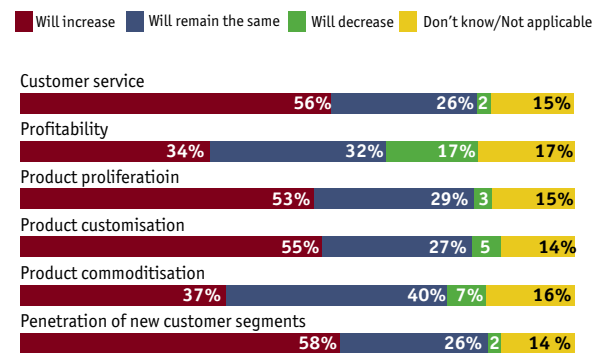
Global banks have positioned themselves around the world in order to capitalise on strong economic growth in emerging markets and the strengthening of large consumer markets. Some of the biggest corporate transactions, such as ABN Amro's recent acquisition by a consortium of other European banks (RBS, Fortis and Santander), have had a direct impact on the Latin American financial market.

In order to assess the effect that globalisation will have on the Latin American banking industry, we conducted a global online survey, sponsored by MasterCard, of 208 financial services executives who deal with the region. The results point to the growing importance of Latin America as an

About the survey

In October 2007 the Economist Intelligence Unit surveyed 208 financial services executives in order to assess the impact of globalisation on the Latin American banking industry. Respondents included representatives of financial institutions that are active in Latin America. They were drawn from a wide cross-section of regions, including South America (23%), North America (22%), Europe (27%—including eastern Europe and the CIS), Asia Pacific (23%) as well as the Middle East and Africa (5%). Sixty-six percent of survey respondents worked for institutions that have fewer than 1,000 employees while 12% worked for organisations that employ more than 10,000 people. More than one-third (36%) were employed by organisations that have less than US\$1bn in global assets, while 23% worked for organisations that have more than US\$500bn in assets. Fifty-nine percent of respondents described themselves as board members, C-level executives or vice-presidents.

How will increased competition impact your organisation's banking activities in Latin America?



investment destination. The quantitative survey was complemented by three interviews with banking experts in the region.

According to Pedro Malan, a former Brazilian finance minister who now chairs Unibanco (one of Brazil's main retail banks), globalisation forces have already led to a revolutionary shift in consumer expectations. The globalisation of consumer patterns and aspirations has also acted as a stimulus towards social mobility. "This is an extraordinary opportunity for banks and their business," says Mr Malan. "Latin America will offer fertile ground for expansion strategies."

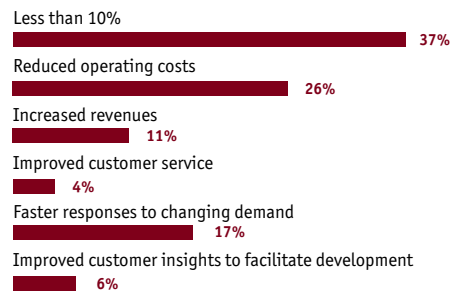
Vicente Rodero, director of a Spanish bank, BBVA, for South America, goes further, predicting that the winners will be the financial institutions that respond more efficiently to consumers' expectations and "customise the financial-product supply according to the profile of each consumer, in a multi-channel focused environment," says Mr Rodero.



Part I: The increasing importance of Latin America as an investment destination—expansion prospects

After hyperinflation and a succession of severe economic crises, Latin America's economic fortunes have been revived in recent years. A deep restructuring of the banking system was implemented in several countries, and a series of foreign takeovers and acquisitions have since taken place. The nature and scope of the activity varies depending on the country. For example, it has been stronger in Mexico than in Brazil. The global acquisition of ABN Amro by a consortium of European banks in 2007 had a direct impact in the region, as one of the bidders, Santander, has a strong interest in developing its activities in Latin America, as part of its globalisation strategy, especially in terms of retail banking. "Latin America has the highest GDP per head among emerging markets, double that of India and 35% higher than China. But if you look at the financial sector, it is still underdeveloped, with low levels of credit-to-GDP ratio," says José Juan Ruiz, director of research and strategy at the Santander Group for the Americas. "Progress has been achieved in terms

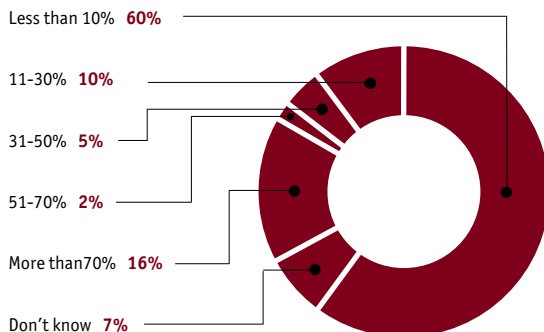
What proportion of your organisation's annual revenue do you expect to come from Latin America in five years' time?



of institutional building, democracies are getting stronger and economies are ready to take off. They need a strong banking sector," he adds.

BBVA's Mr Rodero sees "an increase in consumption and a significant increase in the demand and needs for financial products and services." Meanwhile, consumer preference is becoming more globalised and universal, says Unibanco's Mr Malan: "As income per head increases, there is a gradual alteration in consumption standards toward more global patterns. In Brazil, for instance, there is a strong interest in new, technologically advanced products, which is also an expression of globalisation. This has implications for the expansion of the retail industry: references are becoming more global all the time." As Santander's Mr Ruiz points out: "People are becoming richer and this points to the need to finance their spending."

What proportion of your organisation's annual revenue is currently derived from Latin America?



The wind ahead

Against such a background, banking activity is expected to intensify in the region. More than three-quarters of survey respondents pointed to some form of



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expansion strategy to increase their presence in Latin America, preferably organic growth (23%) or strategic alliance (22%), rather than merger or acquisition (18%) or a joint venture with a local partner (15%).

More specifically, a large majority of executives expect that a greater share of banking revenue will come from Latin America in the medium term. This trend is especially identified by executives based in North America.

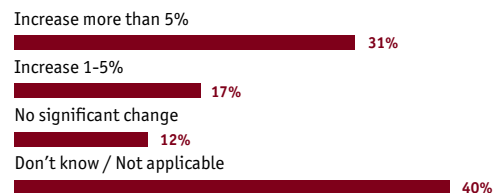
When asked about the proportion of their organisation's revenue that is derived from Latin America, executives based in North America forecast a strong increase. At present, 61% of them say that the region accounts for less than 10% of their revenue.

Brazil, Mexico and Argentina are the most attractive markets in the region. Brazil is clearly identified as the favourite investment destination

However, when asked about their five-year prospects, only 23% of respondents expect that the region will account for less than 10% of their revenue.

Meanwhile, the proportion of those who expect an increase rises significantly: at present, less than 10% say that Latin America accounts for between 11% and 30% of their revenue; one-third of them expect that this will happen in five years' time. Only six respondents say that Latin America currently accounts for more than one-half of their revenue; and 11 of

How do you think your organisation's investment in its cards payments operations in Latin America will change in the next five years?



them expect that this will happen in five years' time.

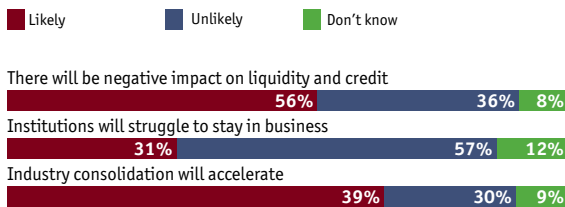
More than one-half of respondents who think that their bank's revenue in Latin America will increase to between 51% and 70% of annual revenue within five years also come from North America. This compares with only about one-quarter at present.

Geography

Brazil, Mexico and Argentina are the most attractive markets in the region. Brazil is clearly identified as the favourite investment destination (71%), probably because of its promising macroeconomic outlook following years of slow economic growth. It is ranked well ahead of Mexico (43%), where there is little room for further acquisition (investment there would rather focus on organic growth), and Argentina (38%), which has revived after a dramatic debt default at the beginning of the decade. Nevertheless, executives based in North America would rather invest in Mexico (58%) than in Brazil (53%) and Argentina (24%). This is likely attributed to the proximity and the integration between the US and Mexican economies. Meanwhile, a large proportion of west European-based executives



Do you think the following are likely outcomes of the current turmoil in international capital markets on the Latin American financial industry by the end of 2007?



selected Brazil as their priority (77%).

The survey indicates a correlation between executives considering investing in Mexico and those who are upbeat regarding retail banking and consumer finance. In fact, Mexico receives its highest marks as a future investment destination opportunities lie in consumer finance (56%) and retail banking (48%).

At the same time, executives who think that corporate banking, investment banking and asset management offer the best investment opportunities overwhelmingly look to Brazil (over 75%) as an investment destination. Among those who see corporate banking as an opportunity, Argentina also receives high marks (54%).

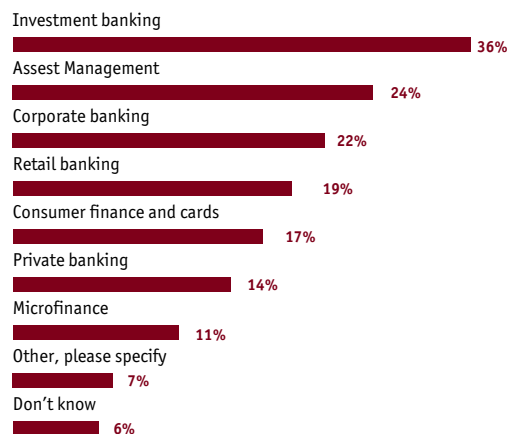
Latin American institutions may eventually become a target, with 56% of respondents saying that many will end up being controlled by newcomers although few admit that their own banks may be acquired in the process. "The consolidation process among the largest banks is largely over in Brazil. I think it would be difficult among the big players here, although it may proceed with smaller institutions," explains Mr Malan.

Business areas

According to 27% of survey respondents, retail banking is the business area where competition is expected to increase the most within the next five years. Interestingly, some retailers have already launched their own banking activities in the region, such as Wal-Mart in Mexico and Mexico-based Azteca in Brazil (Banco Azteca, which is linked to Mexican retailer, Elektra, has recently invested in Brazil and targeted low-income consumers in the north-eastern region). BNP Paribas's consumer credit arm, Cetelem, has also signed partnerships with Carrefour in Brazil as well as with retailers in other countries in the region.

Executives who are based in South America point to retail banking as the best investment opportunity (38%). There are also a large proportion who point to microfinance (30%) as well as consumer finance and cards (28%) as a good investment opportunity.

Which of the following segments do you think offer the best investment opportunities in Latin America for your organisation? Select up to two





Part II: Globalisation versus local market dynamics— the state of retail banking

Competition from foreign banks has been identified as the main feature of globalisation in the financial industry, ahead of the need to invest in information technology (IT). When asked about the specific impact on their own organisation, executives pointed to product customisation, new customer segmentation, and customer service. Mr Rodero, from BBVA, points to the need to “implement a low-cost multi-channel banking model focused on technology and innovation.”

Latin America is perceived as being as vulnerable as other emerging markets. It is also viewed as less fragile than in the past

The quantitative survey points to a correlation between those who agree that “competition from foreign banks will intensify” and those who think that their “organisation’s investment in its card-payment operations in Latin America will increase by more than 5% in five years”. Adds Mr Rodero: “The supply of products will be associated to credit cards, and without a doubt with a proposal for the bank business, which will have a very radical development of multi-channel banking. The services and products supply will have very low costs, as a large part of the population, which will begin to use the banking

system, will require simple and fixed-price products.”

The global economy is expected to have a greater impact on their company’s operations than local markets in the medium term. The main risk to this scenario is the impact of the international financial turmoil in the region. While Latin America is indeed perceived as being as vulnerable as other emerging markets, it is also viewed as less fragile than in the past, which is a sign of investor confidence in the region.

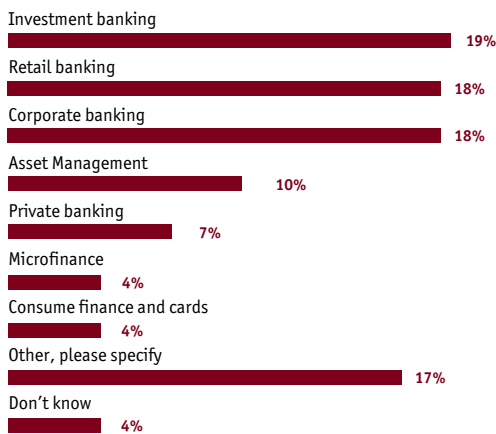
Meanwhile, the primary source of globalisation trends to affect the region is still expected to come from North America (52%). Moreover, the general perception of brands of foreign banks in Latin America is positive, according to 88% of South American-based survey respondents. As a result, there will be less risk of rejection from consumers in the event of foreign acquisitions.

Among those who say that local market dynamics will have the greatest impact on their organisation, 88% say Brazil is one of the most attractive investment destinations. Mr Malan, of Unibanco, also insists that local institutions can still rely on the importance of custom and consumer relationships (thereby fostering trust and loyalty). “The weight of their tradition and their knowledge of the market, customer relationships based on trust and credibility are a great asset,” he says.

Meanwhile, the growth outlook for electronic payment systems looks promising, and its development is seen as a natural trend. Mr Malan sees a great future in credit cards for individual consumers as well as retailers’ own cards and co-branding: “The



Which of the following segments serve as your organisation’s primary income stream in Latin America?



If your organisation intends to increase its presence in Latin America, what type of expansion strategy is it most likely to favour?



potential is still enormous for payments and fund transfers via cards and consumer credit—not only with the main brands, as today there are a lot of large store chains issuing cards that may also be used in other affiliated outlets,” he says.

More than one-half of respondents who gave an opinion on the future of card-payment operations predicted an increase in investment of more than 5% over the next five years, and only one survey taker predicted a decrease of more than 1%. Online banking and e-payment operations are priority investment destinations as competition intensifies.

A large proportion of investment bankers select online banking, card-payment and e-payment operations as key investment priorities in the next five years. The most positive impact of heightened competition, meanwhile, is expected to be a greater access to capital markets (international and local), as well as the effect on revenue and the ability to find a suitable bank as a partner.

Finally, the adoption of best practices is regarded as the most positive impact of globalisation in terms of human resources. Staff recruitment and training is considered to be one of the key investment destinations as competition intensifies. “You have to develop an in-house capacity to deal with all kinds of risks. Today only 40 of our 66,000 [Santander] employees in Latin America are Spanish-born,” says Mr Ruiz.



Conclusion

The global survey of senior financial services executives shows that globalisation will continue to transform the Latin American banking industry. Positive developments in the economy of the region have led to the expansion of the consumer market, which is being targeted by financial and credit institutions. Gains in purchasing power in various countries of the region have also led to an increase in demand for financial services, while financial institutions are ready to expand in Latin America.

In general, Brazil is considered to be the most attractive place to invest by a majority of respondents, ahead of Mexico. Yet, there are important regional variations. North America-based executives surveyed are clearly looking south to invest. They would rather invest in Mexico, which is a member of the North American Free-Trade Agreement (NAFTA), than in Brazil, which is pursuing its own agenda in order to boost South American economic and financial integration.

Retail banking is the business area where competition is expected to increase the most in the medium term while online banking as well e-payment transactions have been identified

as investment priorities. There is still room for improving customer segmentation and product customisation in the region, and companies operating there will have to focus on these issues to boost their competitiveness.

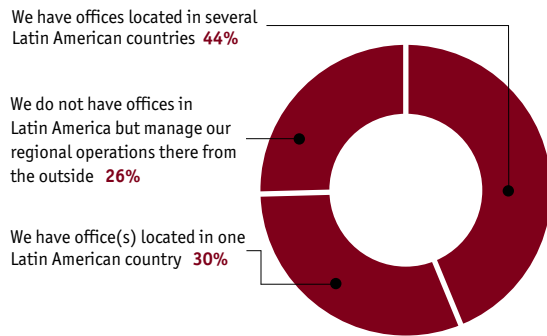
As globalisation trends come mainly from the US, the outcome of the current financial crisis will be likely to be significant and may trigger a new period of uncertainty. One of the key issues to watch will be whether US and European banks that have suffered the most from the sub-prime crisis will redefine their strategies for the Latin American region as a whole.

A majority of survey respondents feel that the global economic conditions are expected to have a greater impact on their company's operations than local market dynamics in the medium term. Nevertheless, Latin America looks less vulnerable than it used to be, which is prompting investors to feel more confidence in the future of the region. As long as key macroeconomic policy and fundamentals remain in place, the region is poised to attract investment in financial services. Brazil is expected to enjoy the benefits of its investor-friendly status, while Mexico may suffer from the current US financial downturn.

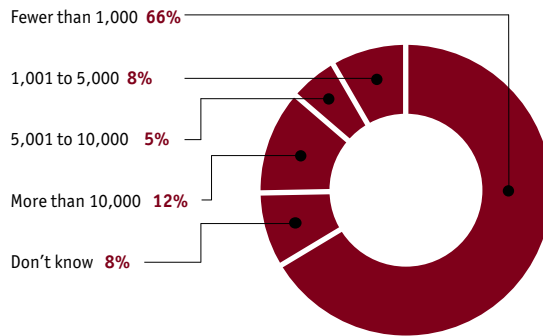
Appendix: Survey results

In October 2007, the Economist Intelligence Unit conducted a global online survey of 208 financial services executives in order to assess the impact of globalisation on the Latin American banking industry. Please note that not all answers add up to 100% because of rounding or because respondents were able to provide multiple answers to some questions.

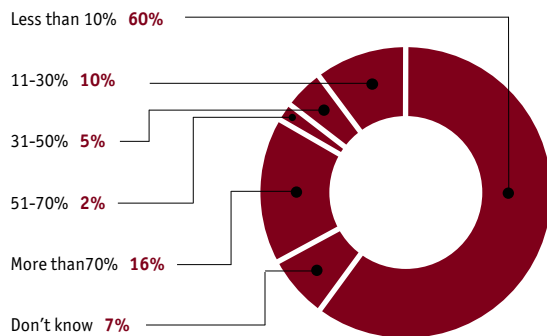
Which of the following best reflects the way your organisation manages its operations in Latin America?



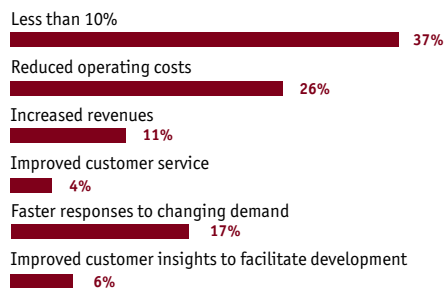
How many employees does your organisation have in Latin America?



What proportion of your organisation's annual revenue is currently derived from Latin America?



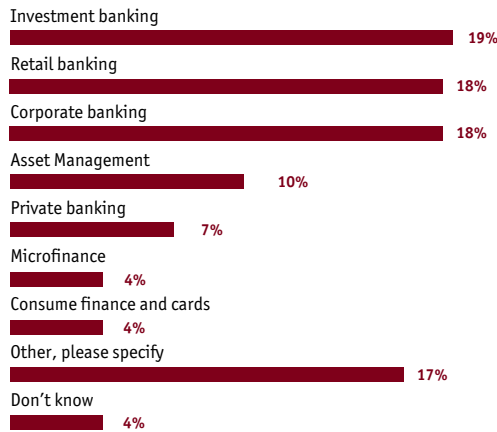
What proportion of your organisation's annual revenue do you expect to come from Latin America in five years' time?



Appendix: survey results

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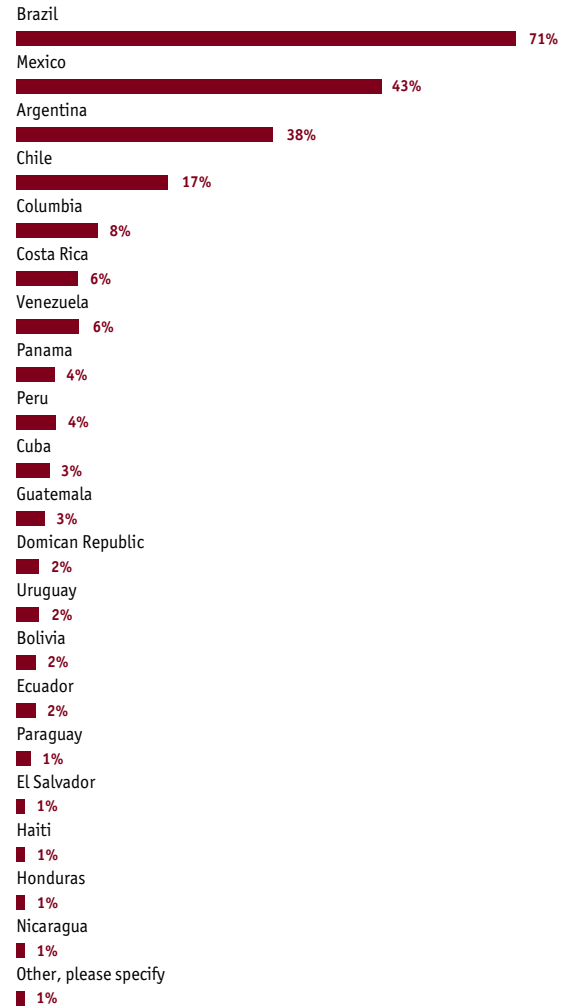
Which of the following segments serve as your organisation's primary income stream in Latin America?



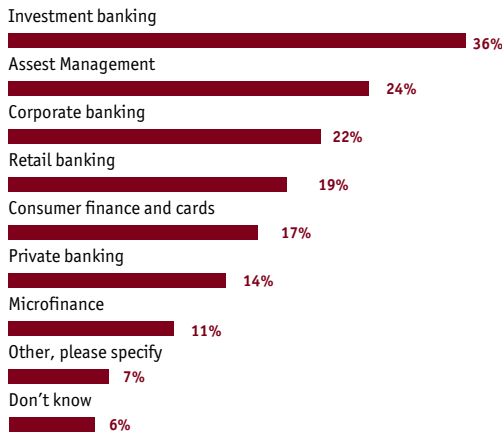
If your organisation intends to increase its presence in Latin America, what type of expansion strategy is it most likely to favour?



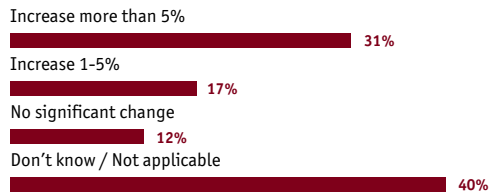
Which Latin American countries (including the country of headquarters, if applicable) will be your organisation's most important investment destinations in over the next five years? Select up to three.



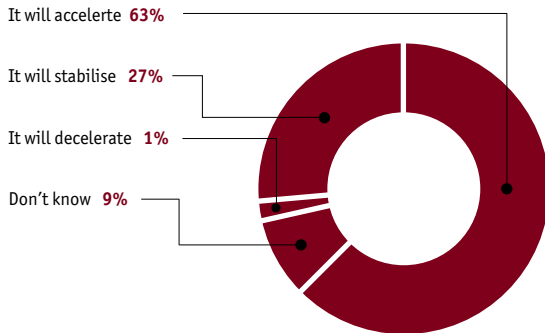
Which of the following segments do you think offer the best investment opportunities in Latin America for your organisation? Select up to two



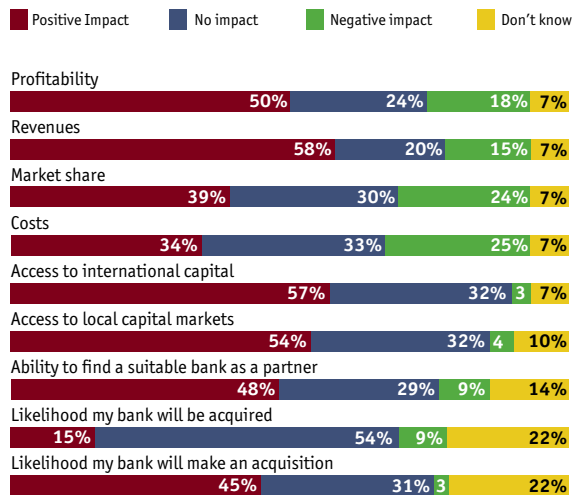
How do you think your organisation's investment in its cards payments operations in Latin America will change in the next five years?



How do you expect consolidation to develop in the financial services industry in Latin America over the next five years?



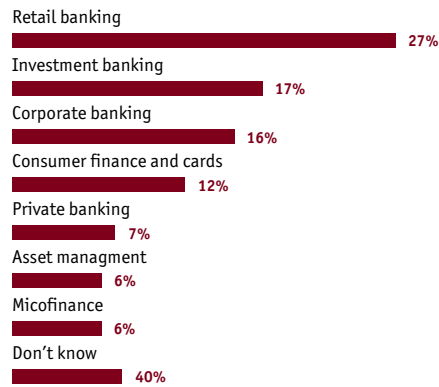
In your view, will increased competition in Latin America have a positive or negative impact on your organisation in the following areas?



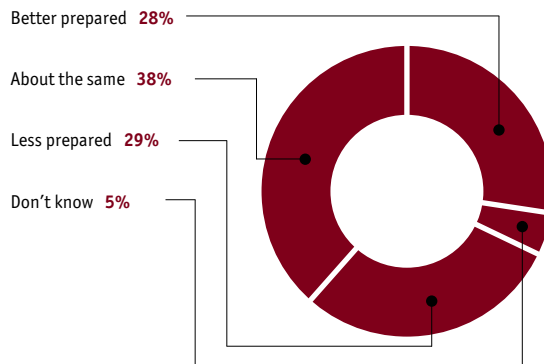
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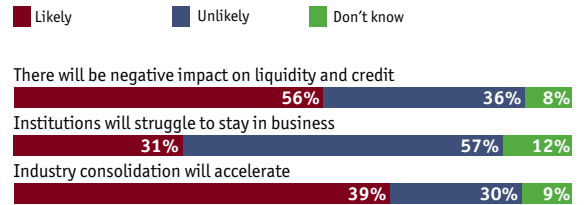
Which of the following segments do you expect will see the greatest increase in competition in Latin America over the next five years?



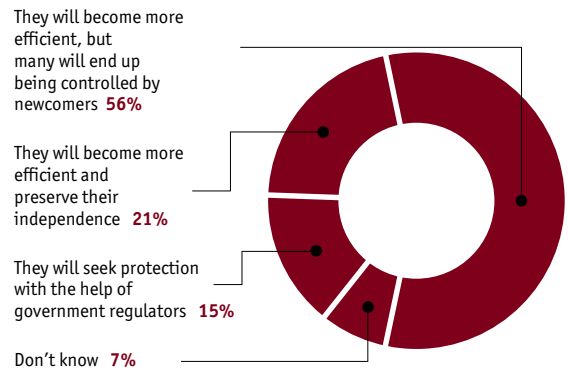
Compared to other emerging markets, how well prepared is Latin America's financial industry to weather this type of turmoil?



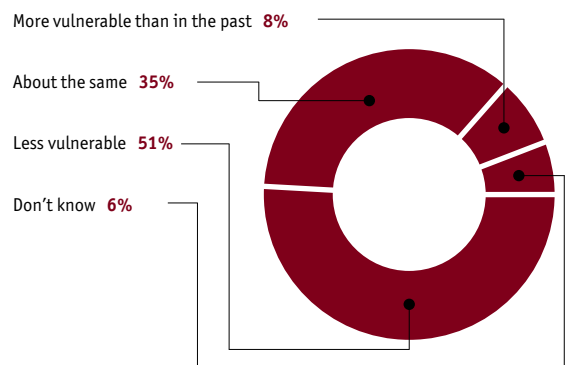
Do you think the following are likely outcomes of the current turmoil in international capital markets on the Latin American financial industry by the end of 2007?



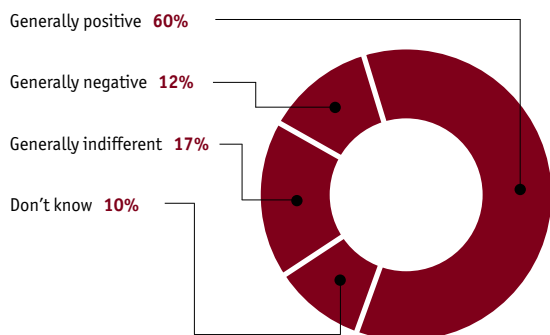
How do you think Latin American banks will adapt to the advance of foreign competitors over the next five years?



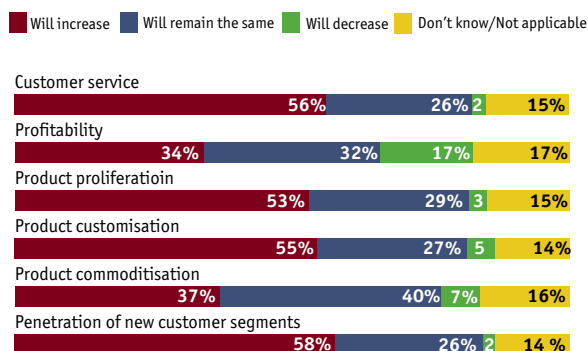
How vulnerable is Latin America's financial industry to this type of turmoil now, compared to the past?



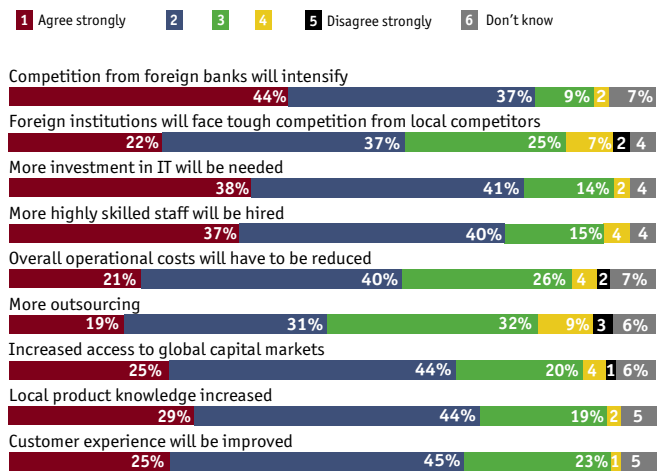
In the country or countries where your organisation operates in Latin America, what is the attitude towards the brands of foreign banks?



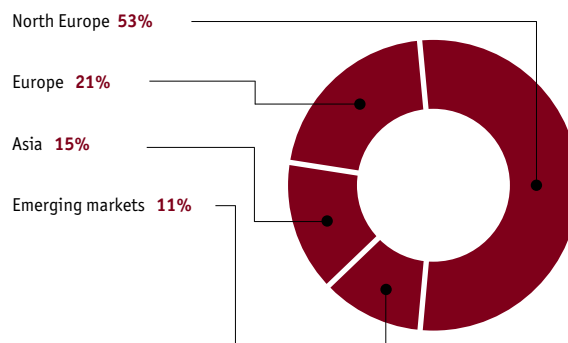
How will increased competition impact your organisation's banking activities in Latin America?



In your view, how will globalisation affect your industry in Latin America?
(Rate on a scale of 1 to 5, where 1=agree strongly and 5=disagree strongly)



In your view, from which region does the primary globalisation trends affecting Latin America come from?



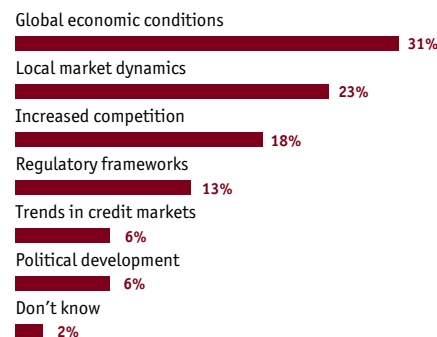
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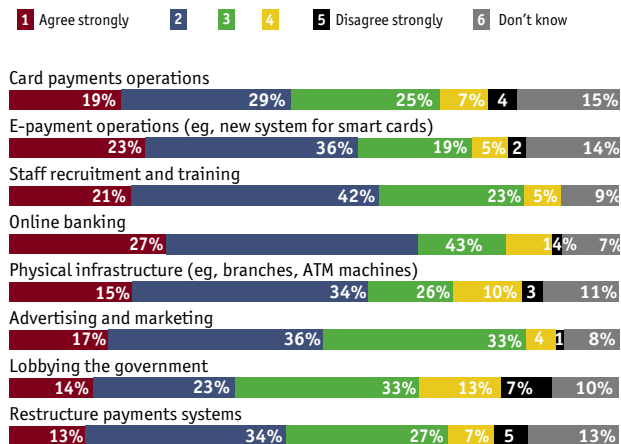
What do you think are the benefits that your organisation's workforce can obtain from globalisation? Select all that apply.



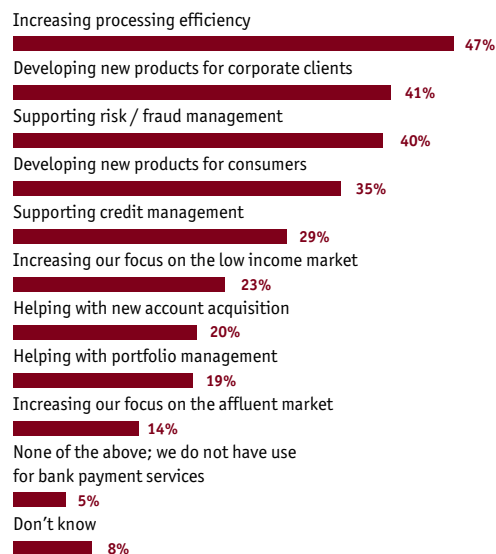
In your view, which of the following factors will have the greatest impact on your organisation's Latin American operations in the next five years?



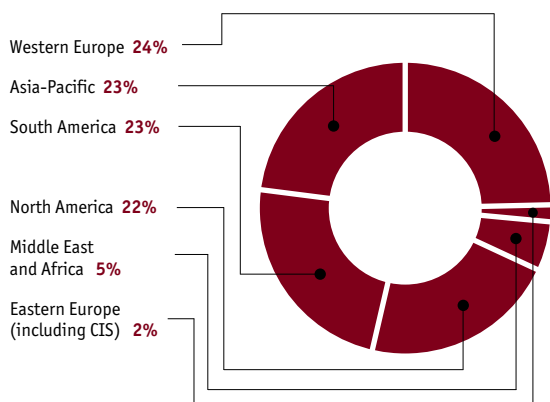
If competition among banks intensifies in Latin America, to which area of the business do you think investment should be directed in the next five years?
(Rate on a scale of 1 to 5, where 1=agree strongly and 5=disagree strongly)



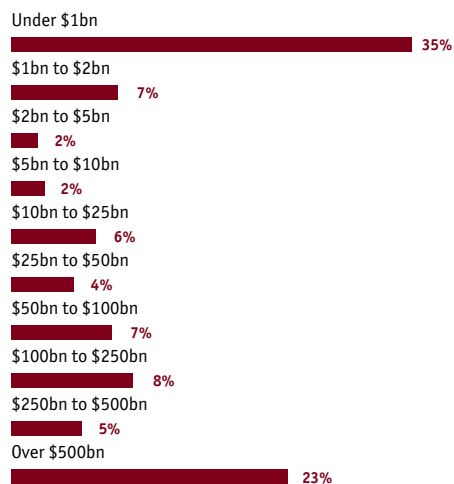
How can companies that provide bank payments services help your organisation to meet its objectives? Select all that apply.



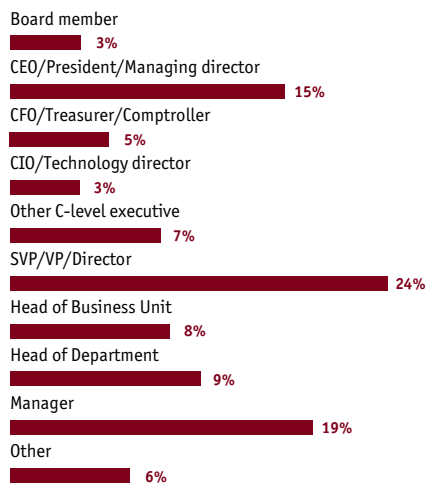
In which region are you personally based?



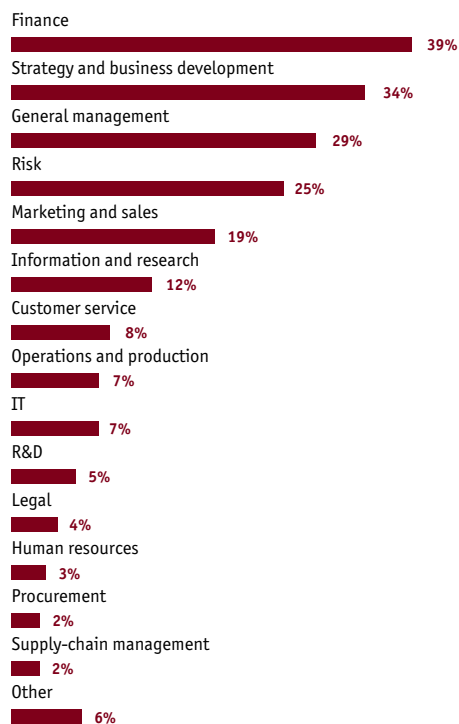
What are your organisation's global assets in US dollars?



Which of the following best describes your title?



What are your main functional roles? Select up to three functions.



While every effort has been taken to verify the accuracy of this information, neither The Economist Intelligence Unit Ltd. nor the sponsor of this report can accept any responsibility or liability for reliance by any person on this report or any of the information, opinions or conclusions set out in the report.

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